United Nations DP/2004/35

Executive Board of the United Nations Development Programme and of the United Nations Population Fund

Distr.: General
14 May 2004

Original: English

Second regular session 2004
20 to 24 September 2004, New York
Item 2 of the provisional agenda
Financial, budgetary and administrative matters

UNDP strategic cost management and implications for cost recovery*

Summary

The present document provides a framework for strategic cost management, and provides an update on its cost recovery policy, as originally presented to the Executive Board at its second regular session 2003 as part of the budget estimates for the biennium 2004-2005 (DP/2003/28).

Following the Joint Inspection Unit report on support costs related to extrabudgetary activities in organizations of the United Nations (JIU/REP/2002/3), United Nations organizations have worked on the harmonization of cost recovery principles to facilitate comparability of cost-recovery policies and practices across organizations. UNDP cost management is aligned with these common principles, particularly regarding the recovery of variable indirect costs. The determination of a single programme support cost or cost recovery rate across multiple United Nations organizations, however, is not feasible as a result of differences in mandates, business models and structures.

Over the last three biennia, the total amounts that UNDP recovered for support increased from approximately $62 million in 1998 to around $149 million in 2003. Owing to system limitations in the past, however, further disaggregate analysis of recovery income, and the necessary structures, was unattainable – a circumstance which is being remedied with the introduction of the new enterprise resource planning system or Atlas.

The ultimate objective of UNDP is the true attribution of all costs to their proper fund source, which is also a prerequisite for results-based budgeting. This approach, combined with continuous monitoring of cost recovery income, will ensure that there is no undue cross-subsidization among various fund sources.

Elements of a decision

In taking note of the report of the Administrator on UNDP strategic cost management and implications for cost recovery, as originally presented in the budget estimates for the biennium 2004-2005 (DP/2003/28), the Executive Board may wish to: (a) take note of the harmonized cost recovery principles, whose adoption by United Nations organizations will result in increased transparency and comparability of cost recovery throughout the United Nations system; (b) endorse the UNDP-specific implementation of these harmonized principles, and their application in the cost recovery policy, particularly regarding the proportional sharing of variable indirect cost among all sources of funds; and (c) encourage UNDP to continue monitoring the level of cost recovered from other (non-core) resources, with the ultimate objective of proportional sharing of all attributable cost among regular resources and other resources in time for the multi-year funding framework 2008-2011.

* The present document was finalized on 14 May 2004 and subsequently forwarded to the ACABQ for its review, which is contained in document DP/2004/36.

04-42552 (E) 030804

Contents

Chapter		Page
I.	Background	3
II.	Principles	3
	A. General terminology utilized by United Nations organizations	3
	B. Harmonized cost recovery principles	4
	C. UNDP business model in the context of cost recovery	5
	D. Cost attribution and the difference between programme and management costs	7
III.	UNDP resources and structure	8
	A. Current regular and other resources	8
	B. Base structure concept	9
IV.	Determination of cost recovery	10
	A. General management support	10
	B. Implementation support services	11
V.	Annex	13
	A. Common definitions in the literature	13
	B. Calculation of the cost recovery rate	14
	C. Comparison of cost recovery practices in UNDG organizations	15
	D. Overview of all UNDP cost recovery mechanisms	16

I. Background

1. In accordance with Executive Board decision 2003/22, the present report provides an update on the new UNDP cost recovery policy, as presented in the UNDP budget estimates for the biennium 2004-2005 (DP/2003/28). It also responds to the expressed desire by the Board for closer cooperation among United Nations organizations, particularly among its funds, programmes and specialized agencies in order to ensure greater harmonization of cost recovery principles and practices.

2. In June 2002, the Joint Inspection Unit (JIU) presented its report "Support costs related to extrabudgetary activities in organizations of the United Nations" (JIU/REP/2002/3), which documented the practices of cost recovery and the setting of programme support cost. The report also highlighted that insufficient cost recovery and differences in cost calculation among United Nations organizations could potentially distort the setting of internal priorities, and lead to avoidable competition for resources among United Nations organizations.

3. The Chief Executives Board for Coordination (CEB), in its comments on the report (A/57/442), underlined the need to harmonize policies among United Nations organizations on programme support cost. At the same time, any new framework would have to take into account the "increasing diversity of the services" provided by various organizations and the "requirement for greater flexibility" in order for organizations to respond to unforeseen demands.

4. Over the last years, the 'market' for development assistance has broadened considerably beyond traditional official development assistance (ODA). At the same time, the voluntarily funded entities of the United Nations system have been challenged by either decreases in or limited levels of untied contributions, as well as by competition from private, semi-private and bilateral entities. Hence, it is essential for United Nations organizations to be more responsive to partner realities and needs in this changing environment.

II. Principles

A. General terminology utilized by United Nations organizations

5. Over time United Nations organizations have introduced and utilized a wide array of terms to describe their funding mechanisms, differences in activities in which they engage, and the corresponding costs and charging methods in the context of cost recovery. All these differences – some fundamental to the nature of each organization, some more of a reflection of independent development over time – make it difficult to achieve comparability across United Nations organizations.

6. That significant differences exist in the way United Nations organizations are funded has concrete effects on how cost recovery is applied. While the United Nations and its specialized agencies assess mandatory contributions to their Member States, United Nations funds and programmes, including UNDP, rely exclusively on voluntary contributions. Nevertheless, most United Nations organizations – exceptions include the World Food Programme (WFP) and the United Nations

Office for Project Services (UNOPS), as per the JIU report – have a concept of untied contributions, often called regular (core) resources, that can be used by the organization in part to finance its minimum business-sustaining costs, as well as core mandated programmatic activities.

7. Many organizations also have a concept of a base structure, funded from their regular (core) budget. The base structure relates to the organization's core mandated activities, as well as statutory functions that do not change with the resource volume that it manages. These core activities typically include regulatory functions, advocacy, norm setting, representation, or management and statutory functions.

8. United Nations organizations also regularly accept earmarked contributions from donors, mostly referred to as extra-budgetary or other resources. Acceptance is subject to an assessment determining whether the contributions thematically fall within the organization's mandate, specifically its strategic framework or master plan. Most organizations have specific guidelines on the type and nature of donors, whose contributions are acceptable, and suitable types and levels of earmarking.

9. Depending on the business of each organization, the type of permissible expenditures – such as programme cost and its treatment – differ. Even within an organization, what specifically is chargeable under a programme is a reflection of that specific programme and the objectives and outcomes it intends to achieve.

10. In consequence, the differences in mandates and operating modalities often blur which costs each organization defines as business-sustaining, which are volume dependent in the context of the organization's operations, and which are subject to cost recovery. In a series of meetings in the context of the High-Level Committee on Management (HLCM), United Nations organizations have agreed on a common definition of principles for the purpose of cost recovery.

B. Harmonized cost recovery principles

11. The objective of cost recovery harmonization is not a uniform programme support cost or cost recovery percentage for all United Nations organizations. Again, this approach would neglect to take into account the great differences in mandates, funding patterns, operational capacities and substantial programme involvement of different United Nations organizations. Instead, the objective is to establish common principles that allow organizations and donors to relate and compare cost recovery practices across organizations.

12. There is broad recognition among United Nations organizations that within the United Nations system competition purely based on lower indirect cost is detrimental to all, because it increases the likelihood that organizations will not recover all cost related to the management of other resources. Organizations should thus avoid any impulse to undercut each other's non-core cost recovery rates.

13. At the same time, building on the comparative advantages of each organization's expertise and capacity is likely to lead to improvements among organizations overall. Differences in cost recovery rates are in part also a reflection of different levels of organizational efficiency. It is, hence, important for United Nations organizations to establish transparency with regard to costs that are either included or excluded in cost recovery.

14. The following key principles for the recovery of indirect cost were derived both from the JIU report, as well as from inter-agency meetings in the context of the Finance and Budget Network (FBN):

(a) Each source of funds bears all its associated cost for the necessary administrative and support structures provided by the organization;

(b) The definition of cost is a reflection of the mandate and the business model of each organization. While United Nations organizations have agreed on a common, harmonized definition of cost categories, each organization needs to match its cost against these categories in order to make them meaningful;

(c) Cost recovery would generally apply to variable indirect costs. In organizations without untied contributions, all indirect costs need to be recovered.

Direct costs

15. Direct costs are all costs that are incurred for and can be traced in full to an organization's activities, projects and programmes in fulfilment of its mandate. Included are the costs of project personnel, equipment, project premises, travel and any other input necessary to achieve the results and objectives set out in programmes and projects.

Fixed indirect costs

16. Fixed indirect costs are all costs that are incurred by the organization regardless of the scope and level of its activities, and which cannot be traced unequivocally to specific activities, projects or programmes. These costs typically include the top management of an organization, its corporate costs and statutory bodies not related to service provision.

Variable indirect costs

17. Variable indirect costs are all costs that are incurred by the organization as a function and in support of its activities, projects and programmes, and which cannot be traced unequivocally to specific activities, projects or programmes. These costs typically include service and administrative units, as well as their related system and operating costs.

C. UNDP business model in the context of cost recovery

18. The sources of funds for UNDP consist of two main categories, with untied contributions coming to the organization in the form of regular resources, and earmarked contributions for trust funds and cost-sharing, referred to as other resources. UNDP, UNFPA, the United Nations Children's Fund (UNICEF) and WFP

have already harmonized the terms 'regular resources' and 'other resources' as part of their budget estimates for the biennium 2004-2005.

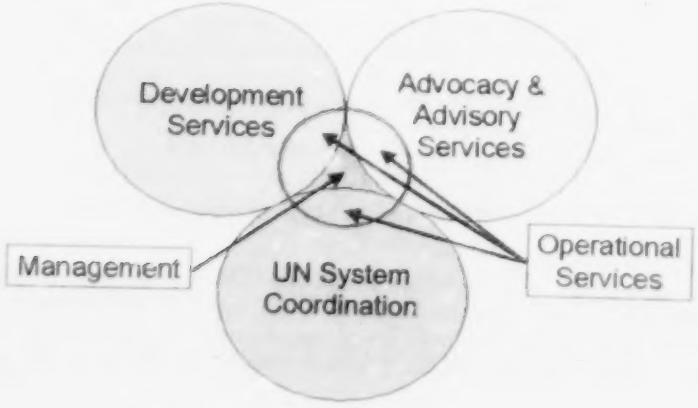
19. UNDP has adapted the harmonized principles and definitions listed above to fit its specific business model (see figure 1), which covers the provision of development services, advocacy and advisory services, and support to United Nations system coordination. The activities in these three areas are undertaken by UNDP in fulfilment of its mandate and are part of its programmes and projects.

20. Consequently, all costs linked to activities under these business lines are considered as *direct costs* on programme budgets, specific to each source of funding, and include programme personnel, fully dedicated equipment and supplies, travel and transportation, services provided directly to the programme, and any other programme input exclusively committed to the programme. Each fund source is responsible for covering all direct costs necessary to achieve the programme objective and attributable indirect costs.

21. As part of its biennial support budget 2004-2005, UNDP introduced the concept of 'base structure', which is linked to the business-sustaining cost that the organization incurs. Aside from statutory functions and top management, the base structure includes the resident coordinator function, together with the country office structures necessary to deliver the minimum programme funded from regular resources (minimum target for resource assignment from the core (TRAC)), which is provided to each programme country in accordance with the new programming arrangements for 2004-2007 contained in document DP/2002/28. In the context of the harmonized cost definitions, the UNDP base structure is considered a *fixed indirect cost*. Given that the base structure encompasses business-sustaining costs unaffected by the volume of other resources managed by UNDP, these costs are not subject to cost recovery. Details on the UNDP base structure are contained in section III-B.

22. The cost for all management and operational services outside the base structure are considered *variable indirect cost*, which fluctuate as a function of the volume of resources managed by the organization. Consequently, each source of funds is charged its proportional share of these variable indirect costs.

Figure 1. UNDP business model



D. Cost attribution and the difference between programme and management costs

23. The classification of costs into direct and indirect is useful in the aggregate analysis of what costs an organization needs to recover. However, these concepts are not easily operationalized; in the abstract, almost all indirect costs could be traced back to the programmes they support. For example, the cost of a unit director, typically an indirect cost, could be split across all the programmes in which the unit director is involved based on timesheets. While this approach might be the most accurate reflection of each programme's true share in the unit director's costs, it is at the same time cumbersome and expensive – there is diminishing additional value in knowing the precise charge for each programme.

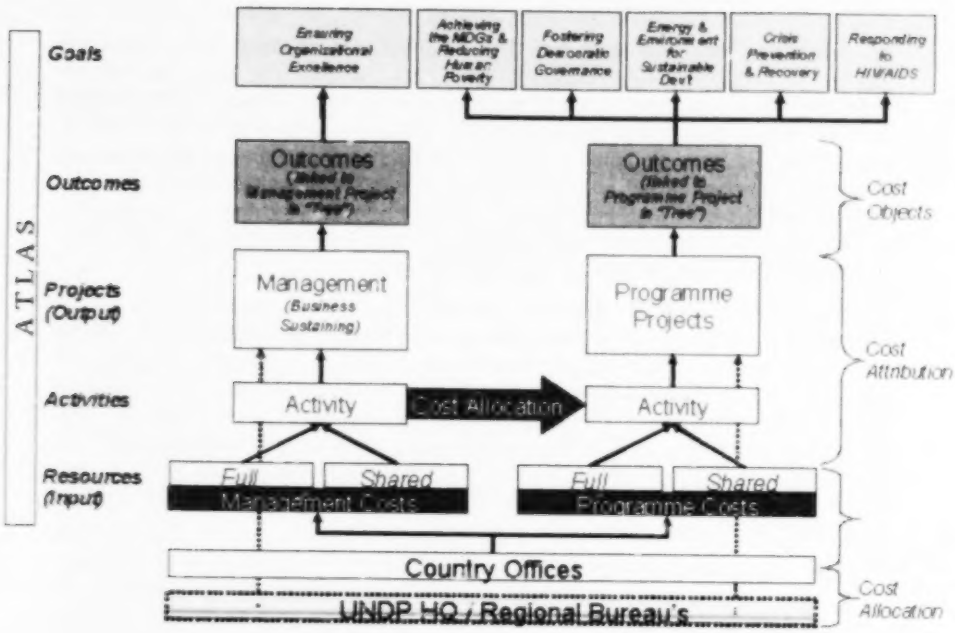
24. Instead of trying to link the cost of every shared input directly to its corresponding programmes or cost objects, organizations recover these as indirect costs. The distinction between the direct cost charged to programmes (programme costs) and the indirect cost related typically to management (management costs), is based on the organization's business model, and the available systems for cost-tracking. In delineating programme costs from management costs, a balance must be struck between the most accurate reflection of the true costs of a programme, and the most practical way of managing and assigning the cost of inputs that benefit a wide spectrum of programmes.

25. The way in which to determine how management costs relate to programme costs is through a process of cost attribution (see figure 2). In essence, cost attribution is the most reasonable approximation of how indirect costs and cost objects relate to each other, based on their cause and effect relationship. In the above mentioned example, a reasonable approximation could be that each programme receives on average the same amount of attention from the unit director, and hence the attribution of the unit director's cost could simply be the quotient of total cost divided by the number of programmes, which means each programme would be charged an equal share of the unit director's costs.

26. The process of cost attribution is different for different types of management costs. For example, the cost of a programme manager backstopping three specific programmes might indeed be distributed based on a time study. The organization's costs for system support could be recovered as a fixed annual user charge. The cost of premises, however, could be shared among all programmes based on their percentage share of occupied space. In all these examples, the critical element is that cost attribution follows a clear cause and effect relationship, in addition to being simple and sufficiently accurate.

27. Ultimately, all management costs must stand in a relationship to the programmes they support, which makes it possible to determine the total cost of the organization's projects, outcomes and goals, which include all the relevant direct and indirect costs. The ability for the organization to "roll up" costs is also a prerequisite for results-based budgeting.

Figure 2. Cost allocation



III. UNDP resources and structure

A. Current regular and other resources

28. UNDP experienced a decline in regular resources from $889 million in 1992 to $645 million in 2000 – a trend that has since then been reversed. At the same time, UNDP other resources have increased tremendously from $409 million in 1992 to $2 153 million in 2002.

29. In 2000, UNDP issued the multi-year funding framework (MYFF) 2000-2003 (DP/1999/30), providing UNDP with the strategic direction for a four-year period, and submitted the second MYFF 2004-2007 (DP/2003/32) to the Executive Board at its second regular session 2003. Both regular and other resources are aligned with the programmatic direction of the MYFF, which sets out the global objectives for the organization. By accepting contributions that thematically fit with the objectives set out in the MYFF, UNDP can avoid any distortions to its work and priorities that might otherwise be caused by the acceptance of large amounts of other resources.

30. As UNDP increasingly accepted non-core resource contributions, recovery of the cost from these resources increased from a total of $62 million in 1998 to a total of $149 million in 2003. (Cost recovery for services of United Nations organizations increased from approximately $3.7 million in 1998 to $13 million in 2003.) Given

the systems that the organization had at the time, it is challenging to disaggregate the amounts into the various components for which cost recovery had been earned. The same is also true for the cost associated with the services that could not be traced unequivocally, because the same structures often serviced regular and other resources, as well as other United Nations organizations.

B. Base structure concept

31. In 2004, UNDP formally introduced a base structure concept for headquarters and country offices, similar to that of other United Nations organizations, as part of the 2004-2005 biennial support budget. The base structure centres on the fundamental functions that UNDP is mandated to fulfil, in particular as custodian of the resident coordinator system. Moreover, with the approval of the 2004-2007 programming arrangements, each programme country is provided at least $350 000 in regular programme resources, and hence the country office structures necessary to implement these resources have become a fixed cost to UNDP.

32. A closer analysis of UNDP presence in programme countries has revealed four base structure archetypes, depending on the mandated functions UNDP discharges (see table 1). Aside from the resident coordinator function, the resident representative also serves as United Nations Humanitarian Coordinator in 21 programme countries. UNDP has a presence in nine net-contributing countries (NCCs), where the programme country government funds the cost of the programme.

33. These functions, which are not subject to change based on the volume of resources managed, are core mandates that UNDP carries out. The costs attributable to the base structure are thus considered fixed cost, covered exclusively from regular resources. All country office costs above the base structure are split proportionately between regular and other resources.

Table 1. Country office base structure typology

Type of presence	Number of offices	Base structure	Average cost
UNDP resident representative	6	1 international professional 2 national officers 3 general service staff	$446 000
United Nations resident coordinator and UNDP resident representative	100	1 international professional 3 national officers 4 general service staff	$518 000
United Nations resident coordinator, United Nations humanitarian coordinator and UNDP resident representative	21	2 international professionals 3 national officers 4 general service staff	$779 000
UNDP resident representative in a net contributor country	9	1 international professional 0 national officers 0 general service staff	$276 000

34. For headquarters units, the base structure concept applies to the management and statutory function, and to oversight bodies (e.g., Office of the Administrator, Comptroller's Division, Office of Audit and Programme Review). While these structures are typically fixed cost, at the same time many of the units also perform a service function, which is subject to change based on the resource volume. UNDP is currently also exploring options for bringing these service elements closer to country offices, with new options emerging following implementation of the UNDP enterprise resource planning system Atlas.

35. As a consequence, for the 2004-2005 biennium, the base structure at headquarters has been aligned with the structures currently funded from regular resources, while those headquarters elements funded from other resources are considered variable indirect cost subject to cost recovery. This delineation between fixed and variable indirect costs will be reviewed and further refined, taking into consideration structural changes resulting from Atlas implementation, and will be presented to the Executive Board as part of the 2006-2007 biennial support budget.

IV. Determination of cost recovery

A. General management support

36. In line with the base structure concept, which is considered a fixed cost in the context of the harmonized cost definition, UNDP assessed the most appropriate option for the recovery of variable indirect cost, which should be covered by each fund source.

37. There are a number of functions that UNDP has to perform before, after and during the lifetime of a programme, where the cost cannot be linked to individual programme activities. These functions mostly relate to the design, oversight and closure of programmes, and include:

(a) Project identification, formulation and appraisal;
(b) Determination of execution modality and local capacity assessment;
(c) Briefing and debriefing of project staff and consultants;
(d) General oversight and monitoring, including project reviews;
(e) Receipt allocation and reporting to the donor of financial resources;
(f) Thematic and technical backstopping through bureaux; and
(g) Systems, information technology, branding and knowledge sharing.

38. The structures necessary to provide these functions are a reflection of the volume of resources managed by UNDP, and consequently each source of funds should pay for its proportional share of the structures necessary to provide general management support (GMS). However, in cases like system support, fundraising and treasury functions, there is not a direct link between the support provided and the individual project, which is why these costs are classified as indirect.

39. Furthermore, there are a number of services where significant learning and experience are built up over time, often to the benefit of subsequent programmes. For new, innovative programmes, in particular, these cost are comparatively higher than for successor programmes. While it might be feasible to track the cost of

project design for each new programme separately, attributing all these costs to the original project would not be appropriate, as then successor programmes would benefit from the knowledge and experience at no cost. The cost of project design and knowledge sharing are thus also considered indirect costs to all programmes.

40. Finally, the GMS fee must also cover the additional risks and liabilities to which the organization is exposed as a consequence of its engagement in other-resources–funded activities. In particular, the risks and liabilities related to the recruitment of staff funded from other resources need to be mentioned as indirect costs, especially because higher mobility means that increasing numbers of staff are funded from a multitude of funding sources during their careers.

41. As the structures providing general management support are mainly funded from regular resources, it is essential that other resources cover their proportional share of these variable indirect costs. To achieve a proportional burden sharing of all variable indirect costs, UNDP has determined a percentage fee that is charged to all programmes funded from other resources for these indirect costs. Programmes funded from regular resources are not subject to the GMS fee.

42. The GMS fee has been set at a range of 5 to 7 per cent for third-party cost sharing and trust funds. As per the calculation presented in the annex, UNDP should ideally recover about 7.6 per cent from other resources. It was felt, however, that the switch from an average cost recovery rate on third-party cost sharing and trust funds of 4 per cent to a new rate of 7 or 8 per cent would be too drastic. Consequently, UNDP has adopted the gradual approach of increasing its GMS rate. The implicit gap in cost recovery resulting from this gradual approach is about $26 million per biennium.

43. There is a significant difference in UNDP involvement in the administration of programme country cost-sharing, particularly as most of these funds relate to government loans from international financial institutions (IFIs) such as the World Bank, and increasingly to government funds. The current level of programme country cost-sharing is at about $900 million per year, which is heavily concentrated in a few countries, with 10 countries comprising about 80 per cent of that amount.

44. The programme country government is often the single UNDP donor for a whole portfolio of programmes, in which a large portion of the actual project design is done by institutions other than UNDP. The concentration of funds from a single donor in one country results in a significant reduction of costs for the organization. Moreover, the UNDP role in implementation and management is more limited, with UNDP facing less risks and potential liabilities. As a consequence, the GMS fee for programme country cost-sharing has been set at an average of 3 per cent measured over the country specific programme portfolio. Owing to its different nature, furthermore, programme country cost-sharing has been excluded from the GMS rate calculation, which instead is done based purely on donor resources (see annex B).

B. Implementation support services

45. UNDP also provides services during programme implementation, either to programme country governments in support of national execution, or to other United Nations organizations in the implementation of their own programmes. Within the

United Nations system, UNDP is the largest service provider at the programme country level, as documented by a recent study of the United Nations Development Group Office entitled "UNDG Survey on Common Services at the Country Level" issued in February 2000.

46. These services relate mostly to administrative transactions, which UNDP performs when there is a lack of qualified local institutions. The services to other United Nations organizations are provided in the context of the UNDP mandate as custodian of the resident coordinator system, and with the overall objective to reduce transaction cost for all United Nations organizations.

47. As a consequence, each service user – government agencies, United Nations organizations – and UNDP is assessed a fee for service, which covers the full cost of the service provided by operational units. These implementation support service (ISS) fees are considered direct costs, based on the harmonized cost definitions, because these are clearly linked to specific activities within programmes and projects. Below is a listing of typical ISSs that UNDP provides:

(a) Payments, disbursements and other financial transactions;
(b) Recruitment of staff, project personnel and consultants;
(c) Procurement of services and equipment, including disposal;
(d) Organization of training activities, conferences and workshops;
(e) Travel authorization, visa requests, ticketing and travel arrangements; and
(f) Shipment, custom clearance, vehicle registration and accreditation.

48. ISS fees have been calculated based on a process and cost survey conducted in over 60 country offices. Taking into consideration differences in local prices, all country offices were grouped into four cost bands, based on their local salary scales, since personnel costs are the major driver of price differences among offices. For each of the cost bands, the cost for each standard transaction was averaged to obtain one average price. The table with these average prices for each standard transaction for each of the cost bands is referred to as the Universal Price List (UPL), which is updated annually to reflect changes in local prices.

49. By utilizing UPL, UNDP ensures that the cost of country-based operations units is fully recovered, particularly as these units are increasingly working on a self-financing principle. Moreover, using the UPL allows each service user to receive the same price for standard transactions, thereby increasing transparency of service provision. At the same time, by using average prices the UPL provides an easy tool for budgeting ISS costs, both for United Nations organizations and UNDP programmes.

V. Annex

A. Common definitions in the literature

Direct cost

- A cost that is incurred for and can be traced in full to a product, service, cost centre or department. This is an allocated cost. Direct costs are direct materials, direct wages and direct expenses. (United Kingdom, Office of Government Commerce, www.itil.co.uk/online_ordering/itil_glossary.htm).
- A cost that is directly attributable to a specific product or service. Some examples include labour hours or materials consumed in the production of an output. (United States, OSD Comptroller, www.dod.mil/comptroller/icenter/inforef/glossary.htm).

Indirect cost

- A cost incurred in the course of making a product providing a service or running a cost centre or department, but which cannot be traced directly and in full to the product, service or department, because it has been incurred for a number of cost centres or cost units. These costs are apportioned to cost centres/units. Indirect costs are also referred to as overheads. (United Kingdom, Office of Government Commerce, www.itil.co.uk/online_ordering/itil_glossary.htm).
- A cost that is associated with a product or service, but not directly attributable to just one product or service. (United States, OSD Comptroller, www.dod.mil/comptroller/icenter/inforef/glossary.htm)

Fixed cost

- A cost or expense that does not vary in the short run with the quantity of output produced. (United States, OSD Comptroller, www.dod.mil/comptroller/icenter/inforef/glossary.htm)
- Fixed costs are operating expenses that are incurred to provide facilities and organization that are kept in readiness to do business without regard to actual volumes of production and sales. Fixed costs remain relatively constant until changed by managerial decision. Within general limits they do not vary with business volume. Examples of fixed costs consist of rent, property taxes, and interest expense. (Jeremiah K. Murphy, CPA, www.jkmcpa.com/Glossary.html)

Variable cost

- A cost that varies with changes in the quantity of output produced when other factors are held constant. The cost of material handling to an activity, for

example, varies according to the number of material deliveries and pickups to and from that activity. (United States, OSD Comptroller, www.dod.mil/comptroller/icenter/inforef/glossary.htm).

- Costs that vary in total dollar amount based on the level of activity or production. These costs increase or decrease as the volume of production rises or falls. (Jeremiah K. Murphy, CPA, www.jkmcpa.com/Glossary.html).

B. Calculation of the cost recovery rate

Regular resources pay for a basic UNDP structure for each country office and headquarters unit, linked to the core functions of UNDP. Above that, the principles of equal burden-sharing between regular and other resources will increasingly be implemented, meaning that each source of funds is expected to pay for its proportional share of UNDP structures.

Total biennial cost of the UNDP structure (donor resources[1]): $706 million

(Minus) Base structure (country offices): –$148 million

(Minus) Base structure (headquarters): –$197 million

Variable indirect cost: $361 million

The objective is to fund these *variable indirect costs* proportionately between regular (37 per cent of total donor resources) and other resources (63 per cent of total donor resources):

Regular resources: $134 million (37 per cent of $361 million)

Other resources: $227 million (63 per cent of $361 million)

Total: 361 million

To recover the variable indirect cost attributable to the other donor resources of $227 million, a percentage rate is calculated by dividing this amount by the total of other resources of $2 994 million. Hence, the ideal cost recovery rate would be 7.6 per cent ($227 million/$2 994 million = 0.0758).

However, UNDP follows a gradual approach to increasing overhead fees over time, and hence the new cost recovery policy sets the GMS fee at a range of 5 to 7 per cent for third party cost-sharing and trust funds. For programme country cost-sharing, the GMS overhead fee was set at an average of 3 per cent, because of the nature of UNDP involvement in these programmes.

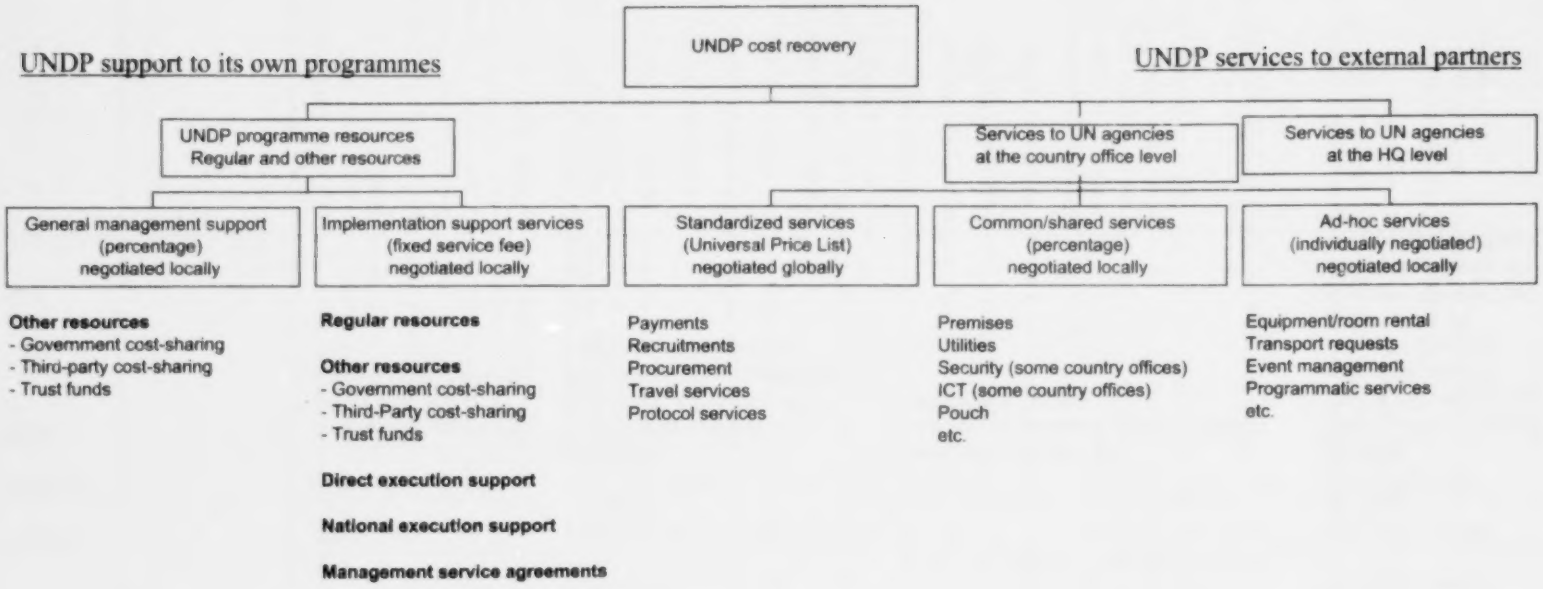
As UNDP service units increasingly operate on a self-financing basis, the cost for these units will shift to extra-budgetary resources, which will reduce the total budgeted cost of UNDP, and is thus expected to bring the ideal cost recovery rate within the range 5 to 7 per cent prescribed by the new policy.

[1] Donor resources as described in the biennial support budget include all regular and other resources, except for programme country cost-sharing.

C. Comparison of cost recovery practices in UNDG organizations

	Cost recovery			
	What is the rate for direct support, and how is it charged?	**Which categories of costs are include/charged as direct support?**	**What is the rate for indirect support, and how is it charged?**	**Are the rates agreed to by responsible bodies?**
UNDP	Actual costs	All cost related to project activities (total cost of ownership), including all cost related to the activation of project inputs, as well as fees for services	Varies between 5 to 7 per cent from Organisation for Economic Co-operation and Development (OECD) donors, and averages 3 per cent for programme country donors (mostly IFI loans) based on both income and expenditures; excludes any overhead charged to executing agencies	The programme support cost rate is calculated as part of the biennial support budget and presented to the Executive Board.
UNFPA	Actual costs	All cost related to project activities	Varies from 5 to 13 per cent. It is charged based upon both income and expenditures.	Executive Board decision
UNICEF	Actual costs	All cost related to project activities	Varies from 7 to 12 per cent. It is charged based upon expenditures.	Executive Board decision
WFP	Zero-based budgeted for each project and not charged on the basis of a rate	All cost related to project implementation, including personnel, travel, equipment, utilities, and rental cost.	7 per cent of estimated direct operating costs of each project	The programme support cost rate is calculated as part of the biennial support budget and approved by the Executive Board. The Board may change the rate during a biennium.

D. Overview of all UNDP cost recovery mechanisms



United Nations DP/2004/36

Executive Board of the United Nations Development Programme and of the United Nations Population Fund

Distr.: General
27 May 2004

Original: English

Second regular session 2004
20 to 24 September 2004, New York
Item 2 of the provisional agenda
Financial, budgetary and administrative matters

Report of the Advisory Committee on Administrative and Budgetary Questions on the report on UNDP strategic cost management and implications for cost recovery*

1. The Advisory Committee on Administrative and Budgetary Questions has considered the report of the Administrator of UNDP on UNDP strategic cost management and implications for cost recovery (DP/2004/35). During its consideration of the matter, the Advisory Committee met with representatives of the Administrator.

2. The report of the Administrator is submitted pursuant to Executive Board decision 2003/22, paragraph 6, requesting "a report on UNDP cost recovery policy to [be submitted to] the Executive Board at its second regular session in September 2004, including the methodology in calculating the rates as well as an update on the adequacy of provisional rates, options for transparent reporting on income from cost recovery, including the possibility of including this income in calculating the next biennial support budget, as well as a comparison with the practice of the other funds and programmes within the United Nations Development Group (UNDG)."

3. The report provides a more detailed picture of UNDP cost recovery policy, including the subject of harmonization of cost recovery principles and practices in UNDG funds and programmes. As such, it is an update of UNDP cost recovery as originally presented in the context of the UNDP budget estimates for the biennium 2004-2005 (DP/2003/28). According to the Administrator, the report does not include any proposal for change or major departure from the current cost recovery policy.

4. In its decision 2003/22, paragraph 5, the Executive Board endorsed, as a provisional arrangement, the approach for cost recovery as contained in paragraphs 130 to 134 of the UNDP budget estimates for the biennium 2004-2005. As indicated in paragraph 132 of document DP/2003/28, over the biennium 2002-2003, the cost

* The present document was finalized by the ACABQ on 27 May 2004.

04-42546 (E) 030804

recovery methodology moved from a 3 per cent across-the-board rate to a 3 to 5 per cent rate range. This was increased to a revised range of 5 to 7 per cent on third-party cost sharing and trust funds for 2004-2005. In the case of local government cost sharing, the cost recovery rate would average 3 per cent for 2004-2005.

5. The Committee was informed that cost recovery for UNDP services continues to revolve around three main areas: (a) services to other resource-funded programmes; (b) services to the United Nations system at the country level; and (c) services to some United Nations entities at the headquarters level. Document DP/2004/35 deals primarily with the cost recovery for support services to programmes funded from other resources. In developing the cost recovery policy, UNDP has categorized the services provided as general management support services, including general oversight, and implementation support services; the latter relates to transactional services provided mainly by country offices directly to programmes and projects (see DP/2003/28, paragraph 131 and DP/2004/35, paragraphs 36 to 49 and annex D).

6. A critical element in UNDP cost recovery policy is harmonization with other United Nations organizations. The Committee was informed that, in a series of meetings in the context of the High-level Committee on Management (HLCM), the executing agencies have agreed on a common definition of principles for the purpose of cost recovery (DP/2004/35, paragraph 10). Based on discussions led by the United Nations Educational, Scientific and Cultural Organization (UNESCO) in the United Nations Financial and Budget Network (a subsidiary body of the HLCM), the agencies have agreed that the objective of harmonization should not be a uniform programme support cost or recovery percentage for all United Nations organizations, fully recognizing that the agencies have different mandates, funding patterns, organizational and operational structures and therefore different cost structures. Moreover, agencies have agreed, in line with recommendations by the Joint Inspection Unit (JIU) (see JIU/REP/2002/3), to common key cost recovery principles that should allow organizations and donors to compare cost recovery practices across organizations. United Nations organizations have agreed on common definitions of cost categories, including various elements of direct costs, fixed and variable costs, and agreed that cost recovery would generally apply to variable indirect cost (see also paragraphs 11 to 17 of document DP/2004/35).

7. The Advisory Committee notes from annex C of document DP/2004/35 that the comparison of cost recovery practices in UNDG organizations is not meaningful, because the basis for the calculation of the indirect support rates is quite different for each organization. In the view of the Committee, all entities concerned need to follow the same template to achieve a meaningful comparison. United Nations funds and programmes should continue consultations for further harmonization of cost recovery principles, with the objective of clearly identifying common elements under each cost category and differences resulting from different mandates and operating modalities.

8. The Advisory Committee is aware that significant differences exist in the way United Nations organizations are funded, in the corresponding funding mechanisms for the administrative and programme support costs and in the methods for cost recovery for support services provided to activities funded from earmarked (other) resources. The Committee agrees with the view that the objective of cost recovery harmonization is not a uniform programme support cost or cost recovery percentage

for all United Nations organizations. It is still possible, in the opinion of the Committee, to standardize most cost recovery rates under commonly agreed cost categories or projects and increase transparency on methods used for calculation of cost recovery rates. The Committee has observed in the past that each service must be paid for by clients, including administrative and management costs, and that an accurate identification of costs to deliver services becomes essential to be able to request a fair reimbursement (see, for example, DP/2001/24, paragraph 5).

9. The Committee was informed that the UNDP cost recovery policy also relates to the concept of a base structure. As part of its biennial support budget for 2004-2005, UNDP introduced the concept of base structure for country offices and headquarters. The base structure is defined as those costs that constitute the minimum critical mass of staff capacity and relating operating costs. These are explained in paragraphs 31 to 35 of document DP/2004/35. The base structure is fully funded from regular resources under the UNDP biennial support budget. Costs over and above the base structure are shared proportionally between regular and other resources (see also DP/2003/28, paragraphs 60 and 83). The Committee notes that, in the context of harmonized cost definitions, the UNDP base structure is identified as a fixed indirect cost and, given the fact that this cost is unaffected by the volume of other resources managed by UNDP, it is not considered subject to cost recovery (see DP/2004/35, paragraph 21). UNDP considers the costs for all management and operational services outside the base structure as variable indirect costs. These fluctuate as a function of the volume of resources managed by UNDP (DP/2004/35, paragraph 22).

10. General management support (GMS) functions, which UNDP has to perform before, after and during the life of a programme, where the cost cannot be linked to individual programme activities, include those listed in paragraph 37 of document DP/2004/35. The structures necessary to provide these functions are a reflection of the volume of resources managed by UNDP. In order to recover the variable indirect costs incurred, each source of funds is charged its proportional share of these variable indirect costs. UNDP will continue to apply the recovery rates endorsed by the Executive Board in decision 2003/22. A general management fee for variable indirect costs, set in the range of 5 to 7 per cent is charged to all programmes funded from other resources by donors for third-party cost sharing and trust funds (DP/2004/35, paragraph 41 and annex C).

11. GMS fees for variable indirect costs for programmes funded from other resources by recipient governments for their own programmes, under the cost-sharing funding modality, has been set at an average of 3 per cent measured over the country-specific programme portfolio. In most cases, under this arrangement, the local government is the single financing source for its own programme portfolio in which a large portion of the project design has been done by institutions other than UNDP (see DP/2004/35, paragraphs 43 to 44 and annex C).

12. As noted above, UNDP also provides services during programme implementation, either to programme country governments in support of national execution, or to other United Nations organizations in the implementation of their own programmes (see DP/2004/35, paragraphs 45 to 46 and annex D). The Advisory Committee notes that UNDP assesses a fee for these implementation support services, which covers the full cost and is categorized as direct cost. UNDP has prepared a schedule, referred to as a Universal Price List, with these average prices

for each standard transaction for each of the services (DP/2004/35, paragraphs 47 to 49 and annex D).

13. Upon enquiry, the Advisory Committee was informed that UNDP had introduced a new information technology system (an enterprise resource planning system named "Atlas"), starting in January 2004, to support the organization in attaining disaggregate analysis of recovery income and a better formulation of requisite structures, which was impaired in the past owing to system limitations. The ultimate UNDP objective is the true attribution of all costs to the proper fund source. The delineation between fixed and variable indirect costs will be reviewed and further refined, taking into consideration structural changes resulting from the implementation of the Atlas system, and will be presented to the Executive Board in the context of the biennial support budget for 2006-2007. The Committee was also informed that the Atlas system was being implemented in UNFPA and UNOPS.

14. The Advisory Committee notes the report of the Administrator and the progress made by United Nations organizations on the subject of cost recovery harmonization. The Committee encourages all United Nations organizations concerned to continue their work in this regard, taking into account the specific issues raised by the Committee in the preceding paragraphs. The objective is to arrive at a fair balance between the need to ensure that core resources do not unduly subsidize project activities while at the same time ensuring that resources available for projects are not unduly diminished. The Committee intends to monitor the progress made in the context of UNDP biennial support budget for the period 2006-2007, and trust that a means can be found to increase transparency in the setting of cost recovery rates.